The Conservative Strategist

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Record momentum leaves value investing in the dust

We just witnessed one of the sharpest quarterly rallies in momentum on record. Investors are piling into the hottest stocks not based on a sober evaluation of their future prospects, but simply because they have worked recently Meanwhile, the kind of value investing that requires patience and fortitude has been forsaken.

Invenomic's take

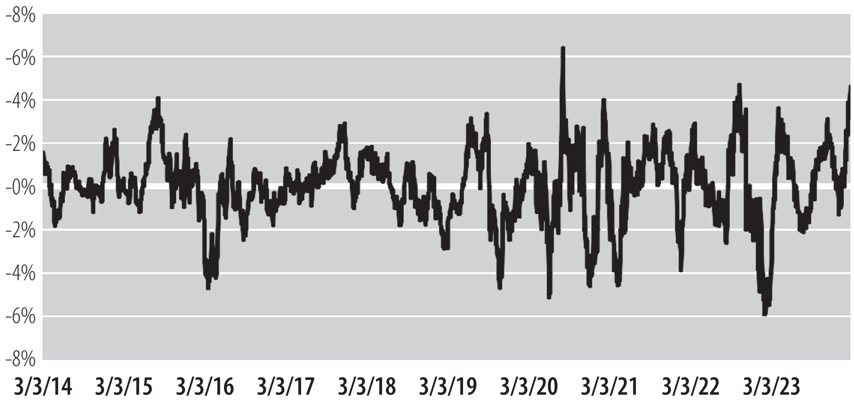
One of our favorite funds is *Invenomic Institutional,* which invests patiently in small-company value stocks while shorting some of the most overvalued high-growth, high-momentum names. As you can guess, this excellent fund has had a rough Q1, down more than 6% year-to-date as of late March, and double digits behind the S&P.

We think this paragraph from its February commentary is worthwhile reading:

"Momentum exposure in hedge fund portfolios is at highs not seen in over twenty years. We view this as a material risk factor when considering it alongside hedge fund gross exposures also near record highs. We are concerned that deleveraging in hedge fund positioning could potentially cause a spike in market volatility. Our process has historically led us to be on the opposite side of hedge fund crowding. This dynamic likely reflects our preference for underloved companies in our long portfolio and overloved companies in our short portfolio. As we look across the market, we are starting to see things get very unbalanced. The concentration in the top 10 names of the S&P 500 Index are at levels not seen since just before the great depression. The relative size of the Information Technology sector to the entire S&P 500 has eclipsed 2008 and 2020 and is sitting at all-time highs. It seems like most market participants are all on the same side of the boat leaving lots of empty seats on the other side."

Momentum factor near 10-year high

Bloomberg US Pure Momentum Portfolio Rolling 2-Month Performance



Momentum factor is approaching the 2020 highs, which was an opportune time to be a contrarian and invest in value stocks. Source: Invenomic, Bloomberg

All in

So just as the momentum factor has reached a multi-decade peak, the market's biggest marginal players, the hedge funds, have plowed into the momentum stocks. This sets up a potential sharp reversal if and as the highest-growth stocks begin to lose their mojo. It's like piled-up tinder in a dry forest.

Money has to move somewhere. We think the beneficiary of this reversal will be the beaten-down value stocks that are at record lows relative to growth stocks at present. ■

The Markets March 31, 2024	Price/Yield	Gain, Qtr	Gain, YTD
US Stocks (S&P 500/Vanguard Index)	5254.35	10.52%	10.52%
International Stocks (Vanguard Index)	19.35	4.34%	4.34%
Emerging Markets Stocks (Vanguard Index)	26.53	1.92%	1.92%
Real Estate Stocks (Vanguard REIT Index)	28.76	-1.20%	-1.20%
Bonds (30 year US Treasury/Vanguard Index)	4.34%	-3.55%	-3.55%
Dollar (US Dollar Index)	104.53	3.16%	3.16%
Gold (London Afternoon Fix)	$2192.70	5.50%	5.50%
Money Market Funds (Vanguard Federal - VMRXX)	5.29%	-0.03%	-0.03%*

*change in yield

Portfolio Planning

The Roth Individual 401k: Handy, and now available at Schwab

For investors, permanent tax relief is spelled R-O-T-H. It's the only way to shelter both accumulations and withdrawals from the tax man for the rest of your life, and beyond.

The good news in 2024 is that Roth IRA contribution limits are rising to $7,000 per year with an additional $1,000 catch-up contribution for those 50 and older, for a total contribution limit of $8,000.

(Income limits apply for contributors: If you file taxes as a single person, your Modified Adjusted Gross Income [MAGI] must be under $161,000 for tax year 2024, and if you're married, your MAGI must be under $228,000. And to get the full contribution, they must be under $146,000 and $230,000 respectively.)

The Roth Individual 401k

The better news — for the self-employed among us — is that the **Roth Individual 401k** allows for much higher contribution limits — and no income requirements.

The Roth Individual 401k, which features as a separate account bundled under the Individual 401k, allows a self-employed individual to contribute after-tax dollars for the annual **employee** contribution of the Individual 401k. (The *employer* contribution, also known as the profit-sharing contribution, must be made pre-tax, if at all, into the pre-tax Individual 401k account).

This provision allows for hefty contributions, since the limits for 2024 for the employee contribution to an Individual 401k are $23,000, plus a $7,500 catch-up contribution for those 50 and older, for a total of $30,500.

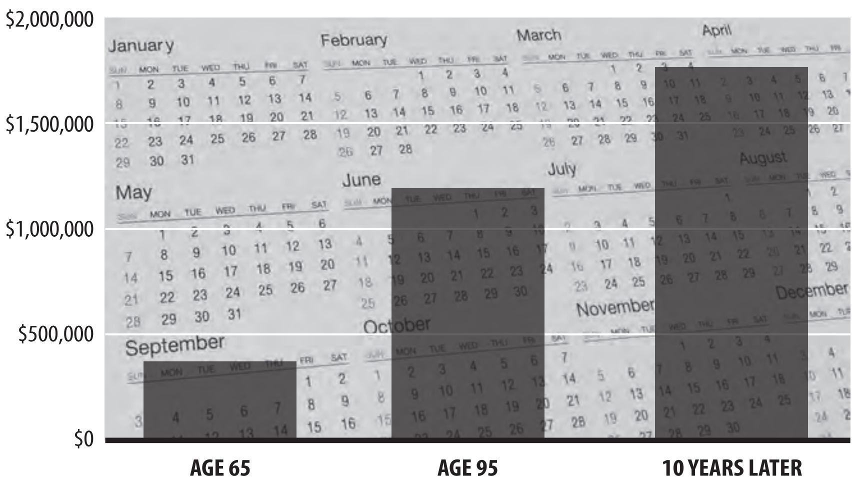
Big numbers possible

Conceivably, a contributor can sock away $305,000 in the Roth Individual 401k over a ten-year period. As the illustration shows, this can then continue to grow tax-free over time and even beyond the life of the contributor, for another ten years before a non-spouse beneficiary needs to remove it from the account. Of course, each spouse can name the other spouse beneficiary, so that a child or other non-spouse beneficiary does not inherit the Roth 401k until the second spouse passes. The duration and accumulation can be quite significant.

Now, of course, the contributor has to have sufficient self-employment income to make the contribution. The law says that one can contribute 100% of self-employment income, up to the above stated limits. So if, for instance, an individual has substantial W2 income, but also a side gig from which she earns $20,000 in 2024, she can put up to the entire $20,000 into a Roth Individual 401k (or a pre-tax Individual 401k), but no more than that.

Roth + Time = Substantial Inheritance

Roth long-term for the win



This illustration shows the accumulation of a Roth Individual 401k account if a 55-year old self-employed person funds it to the current contribution limit ($30,500) every year for ten years until age 65, then holds it to his or her death at age 95, and bequeaths it to a non-spouse beneficiary who holds it for the maximum allowed ten-year period. That's a total of 50 years of tax-free accumulation! We're assuming an annual 4% real rate of return on the account. Final total: More than $1,758,000. No taxes. All figures are in 2024 dollars.

Schwab making it easy

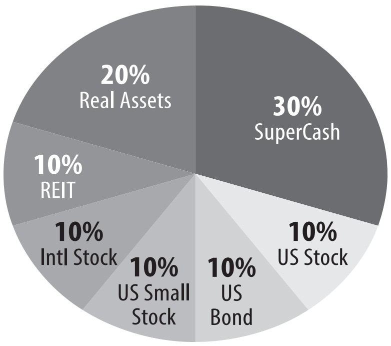
For a while, *TD Ameritrade* offered a Roth Individual 401k, then pulled it shortly before the merger with *Schwab.* But *Schwab* recently announced that it is offering the provision, and it's a simple application process.

If you already have a Schwab Individual 401k, adding the Roth Individual 401k is a matter of completing and signing an Adoption Agreement and Trustee and Custodial Agreement. If you do not yet have a *Schwab* Individual 401k, then we will complete two nearly identical sets of application forms, one for the Individual 401k and one for the associated Roth Individual 401k. Either way, I stand ready to help you through the process. ■

SuperDiversified Portfolios (SDPs)

Again, SDPs lag conventional assets, show solid returns

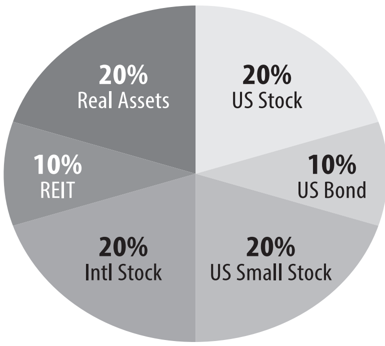
SDP1 *Conservative*



1st Quarter **2.23%**

Last 12 Months **8.19%**

SDP2 *Moderate*



1st Quarter **1.98%**

Last 12 Months **6.64%**

Near the beginning and end of US bull markets, when US stocks are moving sharply higher, our broadly diversified portfolios are bound to underperform a conventional US stock/bond split, and such was the case again this quarter.

But it was also *SDP1*'s fifth positive quarter in the last six, and this quarter's return comes out to well over 9% annualized, which is more than six points ahead of the current inflation rate. When US stocks inevitably turn sharply lower, our portfolios are structured to outperform.

The above model portfolios are not intended to indicate the performance of any real account, but reflect the composite performance, before fees, of the percentage allocations in the asset classes and funds listed in the table below. Seasonal Strategy's actual allocations vary from these models, and among portfolios.

How the Sectors Performed

Real estate getting cheap, and lower rates will help

Asset Class	Mutual Fund	Performance 1st Quarter '24	Performance Last 12 Months	
SuperCash	PIMCO Instl Low Duration	0.21%	3.90%	Best
	Merger	0.53%	4.66%	Worst
	Calamos Market Neutral	1.79%	7.54%	
US Stock	Vanguard Index Trust 500	10.52%	29.70%	
US Bond	Vanguard Long-Treasury	-3.55%	-6.54%	
US Small Stock	Vanguard Small-Cap Index	7.48%	22.36%	
Intl Stock	Vanguard Intl Index	4.34%	12.89%	
REIT	Vanguard REIT Index	-1.20%	8.41%	
Real Assets	PIMCO Commodity Real Return	2.22%	-1.57%	

The Real Estate category disappointed again in Q1, with REITs underperforming our *SDP1* average for the seventh time in the last nine quarters. This has brought Real Estate to a fairly deep state of undervaluation, we think.

A lot depends on the direction of interest rates. In the past, REITs have outperformed handily in the one, two and four quarters *after* the Fed tightening cycle ends. Of course that begs the question: Has the Fed ended its tightening cycle? If not, the REIT bottom may yet be a few quarters away.

Invenomic

Over its seven-year life, *Invenomic Institutional Long-Short* (BIVIX) has beaten the S&P 500 by more than seven percentage points per year, with roughly 18% less risk. The fund tends to buy beaten-down smaller-cap value stocks, while hedging the portfolio by shorting what it sees as overvalued high-momentum growth stocks headed for a fall.

Impressively often, it has scored positive quarters even when the factors have been against it — that is, even when value has underperformed growth, or small-caps have lagged large-caps.

This can only be explained by extraordinary stock-picking skill, which the manager, Ali Motamed (Harvard MBA, CFA) has displayed consistently.

Such skill is rare — and an effective diversifier for our portfolios.

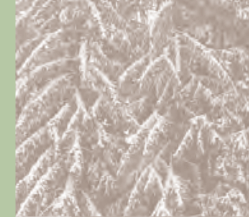
Buy Low, Sell Dear

Characteristics of Invenomic's portfolio as of 2/29/2024

CHARACTERISTIC	LONG	SHORT
Number of positions	177	142
Price-to-Book Ratio	2.9x	14.7x
Price-to-Earnings Ratio	10.5x	38.7x
Enterprise Value-to-Sales Ratio	2.5x	7.9x

According to tried-and-true valuation indicators, Invenomic *is long some of the market's cheapest stocks and short an assortment of bloated and overowned large-caps.*

Source: Invenomic



SEASONAL STRATEGY

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The new 529-to-Roth transfer opportunity

Besides the Roth, the 529 college savings account has been one of the best ways of the past two decades to save and invest tax-free. So good, in fact, that many investors have overfunded their 529s. By the time college rolls around for their child (or grandchild), there are many thousands more in the account than can be reasonably spent on college expenses. (In the case of one of Sue's clients, two grandchildren decided not even to go to college).

Unfortunately, any withdrawals from a 529 account not used for college are subject not only to ordinary income taxes on the accumulated gains, but to an additional 10% penalty on that amount.

When it comes to overfunding, there are three main coping strategies.

Break the 529

The donor can simply take the 529 back and convert it to a plain vanilla taxable account. Sue's client is contemplating that option for the above situation of a grandchild declining college altogether. In this case, taxes will be paid on the accumulation, plus that penalty. This may be a worthwhile play when the 529 is relatively new and the accumulation modest.

Transfer the 529

529 rules allow for the transfer of all or part of a 529 account to other family members who have education expenses ahead of them. These can include not only other children or grandchildren, but nieces and nephews and cousins. In rare cases, even a donating adult can take back the 529 and use it for continuing education expenses. Since there is no time limit on 529 accounts, a 529 can be transferred multiple times and used effectively as a kind of family dynasty trust, which remains tax-deferred indefinitely, and tax-free if eventually used for *someone's* education.

Rothify the 529

Thanks to the recently-passed Secure 2.0 Act, there's another 'out' to overfunded 529s. As of tax year 2024, up to $35,000 of a 529 can now be converted to a Roth IRA for the beneficiary over a period of years, subject to the annual Roth IRA contribution limits (currently $7,000). There are other requirements. The main one: The 529 must have been open for at least 15 years.

Roths are more flexible than 529s

One of the primary advantages of transferring to a Roth is increased flexibility. 529 plans are usually quite restrictive as to the specific investments available and the frequency of trading. Roths, on the other hand, can be invested in almost any listed security — and some unlisted ones as well.

Overall, the 529-to-Roth transfer opportunity is a welcome addition to the already wide array of advantages to the 529 Plan. It makes donor parents or grandparents a bit less averse to funding with substantial amounts, knowing that there is a worthwhile exit strategy for overfunded plans down the road. ■

10 things that may surprise you about 529s

Courtesy of the Vanguard Group

1. 529s aren't just for 4-year colleges
2. 529s pay for more than just tuition
3. Excess 529 funds can be converted to Roth IRA savings
4. You can transfer the plan to a family member
5. Almost anyone can open a 529 (hey, Grandma!)
6. You can open a 529 account for yourself
7. Anyone can contribute to a 529
8. A beneficiary can have multiple accounts
9. Some plans allow for automatic, recurring contributions
10. You can leave your investments to the experts or DIY